

ANALYSIS OF ORIGINAL BILL

Author: Pringle Analyst: Marion Mann DeJong Bill Number: AB 2678

Related Bills: See Legislative History Telephone: (916) 845-6979 Introduced Date: 02/23/98

Attorney: Doug Bramhall Sponsor:

SUBJECT: Restraining Orders Or Injunctions To Prohibit FTB To Collect Or Assess Tax

SUMMARY

This bill would allow a taxpayer to obtain a restraining order or injunction to prohibit the assessment or collection of taxes by filing a statement with the Attorney General (AG) and either paying the amount due or posting a bond to guarantee payment of the amount due.

EFFECTIVE DATE

This bill would become effective on January 1, 1999.

LEGISLATIVE HISTORY

AB 1631 (1998).

SPECIFIC FINDINGS

Under current federal law, taxpayers may be requested by the Internal Revenue Service (IRS) to substantiate items reflected on their federal income tax returns. The IRS may issue a deficiency assessment based on: taxpayers' inability to substantiate items reflected on their income tax return or third party information returns (W-2s, 1099s, etc.). If collection is determined by IRS to be in jeopardy, a jeopardy assessment is issued, whereby the amount of the deficiency is immediately due and payable.

Taxpayers may protest deficiency assessments or jeopardy assessments to the IRS. In the event the IRS denies the protest, under the federal appeals system, the taxpayer may either: (1) seek judicial review of the assessment in Tax Court (which has a small claims division for amounts of \$10,000 or less), or (2) pay the assessment and file a claim for refund with the IRS.

Current federal law generally prohibits injunctions against collection of taxes. Exceptions apply to enjoin premature assessment, levies, and collection action (i.e., IRS tries to collect a deficiency while a case is pending in Tax Court),

DEPARTMENTS THAT MAY BE AFFECTED:

___ STATE MANDATE

___ GOVERNOR'S APPOINTMENT

Board Position:

___ S ___ O
___ SA ___ OUA
___ N ___ NP
___ NA ___ NAR
___ X ___ PENDING

Agency Secretary Position:

___ S ___ O
___ SA ___ OUA
___ N ___ NP
___ NA ___ NAR
DEFER TO _____

GOVERNOR'S OFFICE USE

Position Approved ___
Position Disapproved ___
Position Noted ___

Department Director Date
G. Alan Hunter 3/23/98

Agency Secretary Date

By: Date

to enjoin certain levies or sales, and to recover property wrongfully seized.

Current federal procedures (Rev. Proc. 84-58) allow a deposit in the nature of a cash bond while a deficiency is pending in administrative proceedings or Tax Court. The bond amount may be refunded without interest at any time, and if the taxpayer prevails in administrative proceedings, the entire bond may be refunded to the taxpayer without interest. Federal procedures require a deposit to appeal a decision of the Tax Court.

Under federal law and procedures, if during the administrative review or appeals process a taxpayer pays the deficiency rather than posting a cash bond, the taxpayer must start over from the beginning with a refund claim that is treated as a new case. If the IRS denies the claim or the IRS takes no action on the claim within six months, the taxpayer must file a suit for refund in an U.S. district court or the U.S. Court of Claims.

Under current state law, taxpayers may be requested by the Franchise Tax Board (FTB) to furnish substantiation of the items reflected on their income tax returns. The FTB may issue a proposed deficiency assessment based on: taxpayers' inability to substantiate items reflected on their income tax return, third-party information returns (W-2s, 1099s, etc.), or information FTB receives from IRS. In the rare instance that collection is determined by FTB to be in jeopardy, a jeopardy assessment is issued whereby the amount of the deficiency is immediately due and payable.

If the taxpayer disputes an assessment, the taxpayer may (1) protest the proposed deficiency assessment or jeopardy assessment by filing a written "protest" with the FTB, or (2) pay the assessment and file a claim for refund. If the claim is denied or no action is taken on the claim within six months, the taxpayer may appeal to the Board of Equalization (BOE) or file a suit for refund in Superior Court.

The taxpayer's forum for appealing an adverse FTB action is the BOE. The BOE is the first independent administrative level of review of an FTB action. During the appeal process, the BOE makes an independent determination of the action. The BOE accepts evidence submitted by the taxpayer and, if requested by the taxpayer, grants an oral hearing on the matter.

In the event of a final adverse BOE decision on an assessment, the taxpayer's recourse is to pay the amount due and bring an action for refund against the state in Superior Court. With residency matters payment is not required.

Current state law, like federal law, provides that no injunction or writ of mandate or other legal or equitable process shall issue in any suit, action, or proceeding in any court to prevent or enjoin the assessment or collection of any tax. An exception is provided for suits contesting a *residency determination*. Such suits can be filed with Superior Court without payment of the computed tax

¹ Current federal and California law provide for the payment of interest on overpayments of tax. Cash bonds and "voluntary payments" are not overpayments of tax and thus interest is not paid when cash bonds are released or deposits are refunded to the taxpayer.

liability. The taxpayer must first protest the proposed deficiency assessment, then file an appeal with the BOE. If the BOE determines that the taxpayer is a resident, a suit may be filed within 60 days after the action of the BOE becomes final. No collection action may be taken while the suit is pending.

Under California law, unlike the federal system, a protest or appeal may be converted to a claim for refund upon payment, without the necessity of starting a new administrative process.

The California Constitution (Article XIII, Section 32) provides that no legal or equitable process shall issue in any proceeding in any court to prevent or enjoin the collection of any tax. The taxpayer's remedy is to pay the tax and seek a refund.

Current department practice with respect to payments of tax made during an audit is to treat them as payments for the year in question, and to show them as payments reducing the balance due when the proposed assessment is finally issued. If the payments exceed the proposed assessment amount, the excess is refunded with interest.

If a taxpayer wants to post a "cash bond" rather than make a payment of tax, **current department procedures** treat such payments as "voluntary payments" that do not earn interest. However, this is an unusual occurrence because it is normally beneficial to the taxpayer to have the payment designated as a payment of tax, so that interest can be paid on the overpayment in the event the taxpayer is successful.

This bill would allow a taxpayer to obtain a restraining order or injunction to prohibit FTB from assessing or collecting taxes or any other amounts due. To obtain the restraining order or injunction, the taxpayer must (1) file a statement with the AG within five days before the date the action is filed providing the grounds for the order or injunction and (2) either pay to FTB all amounts due or post a bond with FTB to guarantee payment of amounts due.

This bill would require the amount and terms of the bond and the sureties on the bond to be approved by and acceptable to the judge of the court granting the order or injunction and the AG. The bill provides that approval should not be unreasonably withheld.

This bill would require the application for the restraining order or injunction to state under oath of the applicant (or the applicant's agent or attorney) that the required statements were provided to the AG and that payment was made or a bond was posted.

Legal Considerations

The provisions of this bill are susceptible to constitutional challenge since the California Constitution (Article XIII, Section 32) specifically provides that no legal or equitable process shall issue in any proceeding in any court to prevent or enjoin the collection of any tax.

² The California Supreme court is currently considering whether interest as well as tax must be paid in the case of Agnew v. SBE.

Policy Considerations

This provision would raise the following policy considerations.

- While this bill would allow taxpayers to obtain an injunction and proceed to court at a reduced cost (bonds typically can be obtained for a fraction of their face value, like bail bonds), the purpose of the constitutional bar against injunctions of tax assessments and collections is to ensure that the collection of revenue is uninterrupted.
- This bill may mislead taxpayers. Currently, taxpayers can stop the running of interest by paying the proposed deficiency under protest (automatic claim for refund), and if they are successful, the overpayment is refunded with interest to the taxpayer or credited against other liabilities. Taxpayers that choose to post bonds rather than pay the proposed assessment under protest will earn no interest if successful and the bond is returned. Similarly, the taxpayer will get no deduction on the federal return for taxes paid if they pay with a bond until the bond is converted to a payment of tax, at which time interest will be due.
- This bill would permit an injunction to prevent the collection by FTB of any amount due. FTB collects delinquent child support and certain other non-tax obligations. An injunction to prohibit the collection of these non-tax debts conflicts with the policy to collect these amounts as unpaid taxes.

Implementation Considerations

This bill would raise the following implementation considerations.
Department staff is available help the author resolve these concerns.

- It is unclear how this bill would apply to assessments or collection actions taken prior to the effective date of this bill (January 1, 1999).
- It is unclear whether a restraining order or injunction could be obtained to prohibit a proposed assessment. For example, could a taxpayer seek an injunction during the audit process? If an order or injunction could be obtained to prohibit proposed assessments, it is unclear if the statute of limitations (SOL) is kept open or whether the time for issuing an assessment would expire.
- It is unclear whether a restraining order or injunction would prevent the collection of subsequent assessments on the same tax year (e.g., assessments based on information from the Internal Revenue Service).
- The bill would require the taxpayer to pay the department "all amounts due from the applicant to the state." It is unclear whether this would require the taxpayer to pay amounts other than income tax owed to the state (i.e., employment taxes, sale taxes).

- It is unclear what the effect would be if the bond is less than the full deficiency amount. It is well-established law that no court action may be maintained until the full amount for the year is paid in full.
- Since this bill would allow taxpayers to initiate a lawsuit by posting a bond rather than paying the full liability, more taxpayers may take their cases directly into court without adjudication before the BOE. This would result in increased litigation workloads.

Technical Considerations

If an assessment is paid no injunction is necessary because collection action ceases upon payment. The injunction would only be necessary when the taxpayer posts a bond.

FISCAL IMPACT

Departmental Costs

The departmental costs associated with this provision are unknown. The costs could increase, however, to the extent that more taxpayers litigate.

Tax Revenue Estimate

Revenue losses for any given year are unknown. This bill could cause more litigation cases and possibly create more settlements. It's unknown what impact this change would have in any given year.

BOARD POSITION

Pending.